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LEGISLATIVE UPDATE

RUNAWAY PRODUCTION: AN ANALYSIS OF CALIFORNIA'S LEGISLATIVE RESPONSE TO FILM PRODUCTION INCENTIVES IN OTHER STATES AND ABROAD

I. INTRODUCTION

The West did not dominate the movie industry until after World War I.¹ As the industry developed, motion picture production companies in New York and New Jersey decided California would make a better location for business.² Land was cheaper in California.³ Moreover, its reliable weather and longer days were more suitable for production.⁴ Distance from the East Coast also meant that movie producers, who were often sued by Thomas Edison and his agents for patent infringement, could escape to nearby Mexico.⁵ California's diverse scenery provided for stunning backdrops, and the longer days gave producers maximum access to natural sunlight, the best source of illumination for movie production.⁶ The production studios produced new employment in the state, creating positions for actors, producers, directors, writers,

1. *Film History Before 1920: East and West Coast Film Studio Development*, FILMSITE.ORG (2006), at <http://www.filmsite.org/pre20sintro2.html> (last visited Feb. 6, 2006).

2. *Id.*

3. David M. Halbfinger, *California Considers Tax Breaks For Filming*, N.Y. TIMES, Aug. 18, 2005, at E1.

4. *Film History Before 1920*, *supra* note 1.

5. *Id.*; *The Timeline History of Hollywood: 19th Century*, HOLLYWOOD ENTERTAINMENT MUSEUM, at http://www.hollywoodmuseum.com/whoweare/whoweare_history.html (last visited Feb. 6, 2006) (Thomas Edison and W.K. Dickson developed the kinetoscope, an invention for showing a film by moving it past a light in a box. Motion picture production stemmed from this invention).

6. *Id.*

stuntmen, craftspersons, and technicians, comprising what would eventually become one of the most lucrative segments of California's economy.⁷

In the early 1900s, immigrants, particularly Jews, flocked to California seeking employment.⁸ Undesired in many industries, due in part to racial prejudice, Jews were successful in securing a dominant position in a new business called nickelodeons.⁹ When entrepreneurial producers, like Samuel Goldwyn and the Warner Brothers, arrived in Hollywood, the movie studio was born.¹⁰

By 1930, motion picture production was dominated by Paramount, RKO, Twentieth Century Fox, Metro-Goldwyn-Mayer and Warner Bros.¹¹ Each of these were major "Hollywood" movie studios from the Los Angeles area, owning grand theaters throughout the United States.¹² This "Golden Age of Hollywood," from 1927 to 1948, lured international producers and actors to enter the scene.¹³ After World War I, directors such as Alfred Hitchcock and actresses like Marlene Dietrich joined the supply of California-bred industry talent.¹⁴ Today, Hollywood and other

7. *A Brief History of the California Economy: 20th Century Industries, 1900-1929: Motion Pictures Immigrate*, CALIFORNIA DEPARTMENT OF FINANCE (2006) at http://www.dof.ca.gov/HTML/FS_DATA/HistoryCAEconomy/20th_century_1900.htm (last visited Feb. 12, 2006).

8. Hyde Flippo, *Universal Studios: Universal Pictures and Uncle Carl*, THE GERMAN-HOLLYWOOD CONNECTION, at <http://www.germanhollywood.com/universal.html> (last visited Feb. 12, 2006).

9. *Id.* (Nickelodeons were small neighborhood movie theaters at which admission was obtained for a nickel).

10. *Film History Before 1920: The Major Film Studios: The Big Five*, FILMSITE.ORG (2006), at <http://www.filmsite.org/20sintro.html> (last visited Feb. 6, 2006).

11. *Id.*

12. *Id.*

13. *Film History Before 1920: The Golden Age of Hollywood: From 1930 to 1948*, FILMSITE.ORG (2006), at <http://www.filmsite.org/pre20sintro2.html> (last visited Feb. 6, 2006).

14. *Film History of the 1940s: Anti-Fascist Films*, FILMSITE.ORG (2006), at <http://www.filmsite.org/40sintro2.html> (last visited Feb. 6, 2006) Marlene Dietrich was a cabaret singer in Germany during the 1920s. After Director Joseph Von Sternberg saw her in a Berlin cabaret, he cast her in *The Blue Angel* and she became his lover. He took her to Hollywood to make *Morocco* and she

areas in California continue to be major U.S. centers for motion-picture, television, film, and related entertainment industries.¹⁵ In 1996, sixty-seven percent of the nation's total film and video production employment came from California.¹⁶

Although California still leads the industry, it has faced increasing competition from other states and countries in recent years, putting it at risk of losing its position as the center of the entertainment industry. This phenomenon, referred to as "runaway production," is generally defined as "the flight of film and video production to other countries."¹⁷

Part I of this article details the background leading up to and causing runaway production, including a discussion of the locales, both abroad and in the United States, which pose the largest threat to California's position.¹⁸ Part II describes the legislative attempts by the federal government to keep film production local. Part III discusses legislation, successful or not, initiated in California's own state legislature. Part IV explains the new legislation, A.B. 777, *Taxes: Credits: Qualified Motion Picture Production*, including its anticipated effects and the current state of the bill. Part V explains where A.B. 777 falls short, and why it should not

remained there to star as the femme fatale in many of his films during the 1930s. Bruce Cameron, *Biography for Marlene Dietrich*, THE INTERNET MOVIE DATABASE at <http://www.imdb.com/name/nm0000017/bio>. Hitchcock came to Hollywood in 1939. He went on to produce successful thrillers, such as *Notorious*, *Vertigo*, and *Psycho*. *Hitchcock: Part II*, LENIN IMPORTS (2004) at http://www.leninimports.com/alfred_hitchcock2.html (last visited Feb. 8, 2006).

15. Bernard L. Weinstein & Terry L. Clower, *Filmed Entertainment and Local Economic Development: Texas as a Case Study*, 14 ECON. DEV. Q. 384, 387-90 (2000), 384, available at <http://www.urbanfutures.org/abstract.cfm?id=44> (last visited Feb. 6, 2006).

16. *Id.*

17. Scott Markus, *Slim Pictures: Runaway Production Continues, but May Benefit Chicago Again*, at <http://www.slimpictures.com/chicagofilm.htm> (last visited Nov. 28, 2005) (noting that the term "runaway production" was actually "coined" in the 1980s when many John Hughes films, such as *The Breakfast Club* and *Ferris Bueller's Day Off*, were shot almost entirely in Chicago); Kevin Wright, *The New Film & Video Industry: Getting Our Share*, ADVERTISING & MARKETING REVIEW at http://www.ad-mkt-review.com/public_html/docs/fs030.html (last visited Nov. 28, 2005).

be passed. This section explains why legislation by individual states is essential to accomplishing this goal, but also sets forth the main arguments for why A.B. 777 is inadequate, including controversies over the bill's refundable credits and qualification requirements, and the argument that it fails to address all of the causes of "runaway production." Finally, Part VI will outline proposed alternative solutions.

II. THE EROSION OF HOLLYWOOD'S DOMINANCE IN FILM PRODUCTION

California has been losing its luster to runaway production for years, as filmmakers and television producers are enticed by tax incentives in Louisiana, New Mexico, Illinois, and other states, and cheaper labor and favorable exchange rates in places such as Canada, Eastern Europe, and Asia.¹⁹ Los Angeles's Entertainment Industry Development Corporation (LAEDC) has tracked the number of feature film production days in California since 1993, and the state saw a thirty-seven percent decline between 1996 and 2004.²⁰ Between 1992 and 1993, almost \$4 billion was spent on productions that occurred outside the state of California, and an additional \$1.3 billion was spent in Canada.²¹

While runaway productions have existed since the late 1940s, the 1990s saw a huge surge in the number of films leaving the United States.²² A 1999 study by the Directors Guild of America (DGA) and the Screen Actors Guild (SAG), revealed that between 1990 and 1998, runaways increased by thirteen percent of total U.S. film and television productions, creating a loss of over 125,000 jobs.²³ The LAEDC forecast the loss of another 4,000

19. Halbfinger, *supra* note 3.

20. *Id.* "These figures exclude production days on studio lots, for which permits aren't required." *Id.*

21. Weinstein & Clower, *supra* note 15.

22. Christina Klein, *The Hollowing-Out of Hollywood: 'Runaway productions' boost profits but also take jobs abroad*, YALEGLOBAL ONLINE, Apr. 30, 2004 at <http://yaleglobal.yale.edu/article.print?id=3794> (last visited Feb.12, 2006).

23. *Id.*

film jobs by 2005.²⁴

Runaway productions fall into one of two categories: Creative Runaways and Economic Runaways.²⁵ Creative Runaways are productions filmed in a location because a substitute for that place would hinder the telling of the story.²⁶ The director of the historic film *The Last Emperor*, for example, decided to film on location in China's "Forbidden City" because he said it "helped to make [his] movie a masterpiece."²⁷ In contrast, Economic Runaways occur when a production changes locations in order to lower costs.²⁸ Approximately twenty-six percent of the movies and television productions developed in the United States in 1998 fell into this category.²⁹

The number of motion pictures being made outside of California has state leaders primed to enact subsidies.³⁰ Legislators are seeking to help the working production people, rather than the big stars, for fear that these employees will not have enough work to sustain a living in California because too much of it will go to other states and foreign countries.³¹ California is now in the midst of a production war, as fourteen states have passed incentive legislation in 2005 alone.³²

A. Threats from Abroad

Outsourcing post-production work has long been a common practice, but film industry workers are now concerned about films

24. *Id.*

25. Amy Johnston, *Runaway Movie Production: From Hollywood to Canada*, 11 TED CASE STUDIES 630, ¶ 20, (Jun. 2001) at <http://www.american.edu/TED/runaway.htm> (last visited Feb. 10, 2006).

26. *Id.*

27. *Id.*; see also Hal Erikson, *The Last Emperor*, THE NEW YORK TIMES: MOVIES at http://movies2.nytimes.com/gst/movies/movie.html?v_id=28316 (last visited Feb. 12, 2006). The Last Emperor is the true story of Aisin-Gioro Pu Yi, the last ruler of the Chinese Ching Dynasty. *Id.*

28. Johnston, *supra* note 25, ¶21.

29. *Id.*

30. Halbfinger, *supra* note 3.

31. *Id.*

32. See *Id.*

and television shows being produced almost entirely outside of the United States.³³ Similar to manufacturing, the film industry now operates on an international level, and in order to keep up with competition from other countries, the U.S. needs to offer its own incentive programs.³⁴

Numerous factors have led to the globalization of the film industry. These factors include a higher worldwide demand for films, the development of international production companies, the formation of high technology studios abroad, and monetary incentives offered by foreign countries.³⁵ Frequently, the dollar is stronger in other countries, so studio executives reason they will get more for their money in foreign locations.³⁶ Even though most runaways still hire Americans to fill the positions of producer, director, and star, most everyone else is hired locally.³⁷

Even the small number of runaways that occurred in the early 1990s significantly impacted the economy.³⁸ Film production-related services lost their economies of scale.³⁹ Equipment rental companies, for example, require steady year-round demand in order to operate.⁴⁰ When sound stages in California, New York, Illinois, and Florida began operating below capacity, many small and medium-sized companies went out of business.⁴¹

33. Klein, *supra* note 22.

34. *States Push Tax Breaks in Hope of Luring Movie Business*, 19 Action News at <http://www.woio.com/global/story.asp?s=3629514&ClientType=Print> (last visited Nov. 29, 2005) (quoting Alex Schott, director of the Louisiana Governor's Office of Film and TV).

35. Jean Ross, *Budget Brief: Are Refundable Tax Credits Needed to Save California's Film Industry?* CALIFORNIA BUDGET PROJECT, at http://www.cbp.org/2005/0508_bbmoviecredits.pdf (last updated Aug. 2005).

36. Markus, *supra* note 17.

37. Klein, *supra* note 22.

38. U.S. DEP'T OF COMMERCE, THE MIGRATION OF U.S. FILM & TELEVISION PRODUCTION (Mar. 2001) available at <http://www.nyc.gov/html/film/pdf/migration.pdf> (last visited Feb. 5, 2006).

39. *Id.*

40. *Id.*

41. *Id.*

1. *Canada*

The competition for runaway productions began in Canada, with its introduction in the early 1990s of generous tax credits to entice low-budget film-makers from Los Angeles.⁴² Filming in Canada is estimated to be at least twenty percent cheaper than filming in the United States.⁴³ The country hosted over eighty percent of all runaways in the late 1990s,⁴⁴ and now provides an uncapped sixteen percent refundable tax credit on labor costs.⁴⁵ To demonstrate how dramatic these incentives are, a \$12.6 million budget production can save \$3,150,000 by filming in Canada, compared to a savings of \$391,864 in New York, and a mere \$40,371 in Illinois.⁴⁶

Canada currently works with fifty-eight other countries under a co-production treaty; however, the United States is not one of them.⁴⁷ The treaties, administered by Telefilm Canada, provide minimum standards for financial and creative participation.⁴⁸ Qualifying co-productions are eligible to receive all of the same government benefits as Canadian films.⁴⁹ However, U.S.-

42. Johnston, *supra* note 25.

43. Carol Harte, *Creating Visual Media in Illinois: A Plan for Sustained Growth 2003 and Beyond*, ILLINOIS PRODUCTION ALLIANCE, at 10.

44. Klein, *supra* note 22; Halbfinger, *supra* note 3. (noting that the California Film Commission reports that Ontario and British Columbia offer thirty-four percent, while Manitoba's incentive reaches forty-five percent).

45. Halbfinger, *supra* note 3.

46. Harte, *supra* note 43.

47. *International Incentive Programs*, MARK LITWAK'S ENTERTAINMENT LAW RESOURCES, 2003, at http://www.marklitwak.com/resources/international_programs.html (last visited Nov. 11, 2005); see TELEFILM CANADA: Guidelines, at <http://www.telefilm.gc.ca/04/41.asp>. (last visited Nov. 11, 2005) ("The official co-production agreements enable Canadian producers and their foreign counterparts to pool their creative, artistic, technical and financial resources to co-produce films and television programs that enjoy the status of national productions in each of the countries concerned.").

48. *International Incentive Programs*, *supra* note 47. Telefilm is a corporation that invests in Canadian film, television, and music. The corporation also provides financial and strategic help to media reflecting Canadian society. TELEFILM CANADA, *supra* note 47.

49. *International Incentive Programs*, *supra* note 47.

controlled enterprises do not qualify as Canadian for purposes of the treaties.⁵⁰

Canada also offers the Canadian Film or Video Production Tax Credits, administered by The Canadian Audio-Visual Certification Office (CAVCO) and the Canadian Customs and Revenue Agency (CCRA).⁵¹ The refundable credit, which amounts to twenty-five percent of expenditures for services provided by Canadians, is only for Canadian films, and to qualify, either the director or screenwriter and one of the two highest paid actors must be Canadian.⁵² Additionally, Canada offers the Production Services Tax Credit, which provides production service companies that have contracted with the copyright owner an eleven percent tax credit.⁵³ Finally, each of Canada's ten provinces provide additional inducements.⁵⁴ For example, British Columbia offers an eleven percent production services tax credit on qualifying wages paid to its residents.⁵⁵ When the incentives offered by the Canadian provinces are added to the monetary enticements the country provides at a federal level, the savings are considerable.⁵⁶

Despite these motivations, Canada is losing its competitive position to countries offering even cheaper labor and facilities, such as China and Brazil.⁵⁷ Bulgaria, the Czech Republic, and Romania are also "attracting more high-profile film productions as producers travel in search of savings."⁵⁸ Due to the thirty to forty

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*; see Harte, *supra* note 43, at 16.

55. *International Incentive Programs*, *supra* note 47. Information about other Canadian incentives can be obtained from the appropriate agency: Alberta (www.cd.gov.ab.ca/affta), Saskatchewan (www.saskfilm.com), Manitoba (www.mbfilmsound.mb.ca), Ontario (www.omdc.on.ca), Quebec (www.investquebec.com and www.sodec.gouv.qc.ca for dubbing tax credit), New Brunswick (www.nbfilm.com), Nova Scotia (www.film.ns.ca), Prince Edward Island (www.gov.pe.ca and www.techpei.com), Newfoundland and Labrador (www.newfilm.nf.net) and Yukon (www.reelyukon.com). *Id.*

56. Harte, *supra* note 43.

57. Klein, *supra* note 22.

58. Catherine Elsworth & Matthew Brunwasser, *Why the Home of the Stars is Losing its Allure*, THE DAILY TELEGRAPH (London), Aug. 20, 2005, at 15.

percent savings a producer can realize in Bulgaria, Nu Image, one of the biggest production companies in the United States, has shot forty films and spent a total of \$200 million in Bulgaria since 1998.⁵⁹

2. *Australia*

Australia is also a strong competitor, offering a tax offset for big-budget films shot in Australia under Divisions 10BA and 10B of the country's Income Tax Assessment Act of 1936 (ITAA).⁶⁰ The credits are refundable, meaning that the offset amount is applied against Australian Federal tax liabilities which accumulate during production, and if these liabilities are lower than the total credit, the excess is refunded.⁶¹ These credits are not available for low budget independent films, and do not provide actual cash financing to make the movie, meaning the producer has to find another way to raise production dollars.⁶² The goal of Division 10BA is "to encourage private investment in culturally relevant, high quality Australian film and television productions."⁶³ 10BA grants investors a one-hundred percent accelerated tax deduction

59. *Id.*; see *The Return of Rambo*, NU IMAGE FILMS/MILLENNIUM FILMS, May 29, 2005 at <http://www.comingsoon.net/news.php?id=9819>. Nu Image Films, established in 1992 by Avi Lerner, has produced on average fifteen to eighteen low-budget and foreign-sale films per year. In 1996, the company formed Millennium Films to meet a higher demand for art films and action features. Nu Image has produced forty films at their studios in Sofia, Bulgaria since 1999, and has plans to film many other high-budget films in 2006, including *Rambo IV*, *The Black Dahlia*, starring Scarlett Johansson and Josh Hartnett, and *Poe*, a film about the life and writings of Edgar Allan Poe. *Id.*

60. *International Incentive Programs*, *supra* note 50; see generally AUSTL. GOV'T: DEP'T OF COMMC'NS, INFO. TECH. & THE ARTS, FILM TAX INCENTIVES – 10BA AND 10B, available at http://www.dcita.gov.au/arts/tax/film_-_tax_incentives_10ba_and_10b. (last visited Nov. 11, 2005).

61. *International Incentive Programs*, *supra* note 47.

62. *Id.*

63. AUSTL. GOV'T: DCITA: FILM TAX INCENTIVES – 10BA INFORMATION SHEET, available at http://www.dcita.gov.au/arts/tax/film_-_tax_incentives_10ba_and_10b/film_tax_incentives_-_10ba_information_sheet (last visited Feb. 7, 2006).

in the year that the investment is made.⁶⁴ Only feature films, documentaries, television-movies, and mini-series qualify under this division.⁶⁵ It must also be substantially filmed in Australia or be an official co-production, and have “significant Australian content”.⁶⁶

Division 10B of ITAA accepts more television formats including series, multimedia and educational programs.⁶⁷ To qualify, the producer must own the copyright to the production.⁶⁸ 10B offers a tax deduction over two fiscal years, but 10B films are not eligible for Australian Film Finance Corporation financing.⁶⁹

The Film Finance Corporation Australia Ltd. (FFC) receives money from the government every year to help fund Australian films, television movies, mini-series and documentaries.⁷⁰ The FFC will only invest in projects if they are also co-financed by a private investor or distributor.⁷¹ As a pre-requisite to providing financing, the producer must enter into at least one transaction with a third party (e.g., obtaining television licenses, guarantees, advances or pre-sales from distributors) in order to ensure that there will be a market for the project when completed.⁷²

Even if the film is not “substantially Australian,” the Australian government incentives may be available to the producer pursuant to an official co-production treaty.⁷³ Australia is under treaty agreement with the United Kingdom, Canada, Ireland, Italy, Israel, France, and New Zealand.⁷⁴

64. *Id.* For example, by investing \$50,000 in a 10BA project, the investor will be able to lower their taxable income by \$50,000 for that financial year. *Id.*

65. *Id.*

66. *Id.* Some elements considered when assessing whether a film has “significant Australian content” are who has creative control, the subject matter, the country where the film originated, who the copyright owner is, who owns the companies involved in the production, and the sources of funding for the project. *Id.*

67. *International Incentive Programs*, *supra* note 47.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *International Incentive Programs*, *supra* note 47.

74. *Id.*

In addition, the state governments in Australia may also provide incentives.⁷⁵ For example, Queensland offers a payroll tax rebate, an eight to ten percent rebate on cast and crew salary, an internship scheme under which eighty percent of wages are paid, and a rebate on money spent for traffic and fire services.⁷⁶ The only drawback is Australia's immigration law which makes it difficult for a producer to obtain permission to hire an actor from abroad.⁷⁷

3. *International Style*

The growing trend of off-shoring production has also been due to the increasing number of films generating media attention due to their "global" style, which appropriates stylistic elements from such genres as Hong Kong kung fu movies, Japanese samurai films, and Italian Westerns, as seen in, for example, the *Kill Bill* films.⁷⁸ Nonetheless, California legislators' concerns are focused on those films leaving the United States to be shot abroad solely for economic, rather than stylistic, reasons.⁷⁹

B. Threats at Home

With sales of over \$300 billion, the communication/entertainment industry was the eighth largest industry in the United States in 1997.⁸⁰ Fifty billion dollars of this (seventeen percent) was spent on filmed entertainment in the form of box office receipts, home video, and made-for-TV movies.⁸¹ States not traditionally seen as film production states are also entering the arena, competing to attract production by offering tax credits and other incentives.⁸² California lost almost \$4 billion income between 1992 and 1993 due to productions that went out of the

75. *Id.*

76. *Id.*

77. *Id.*

78. Klein, *supra* note 22. This is akin to the "Creative Runaways" discussed above; see *supra* Part II.

79. Klein, *supra* note 22.

80. Weinstein & Clower, *supra* note 15.

81. *Id.*

82. *Id.*

state.⁸³ When a production is filmed in an atypical location, it draws tourism to that city by exposing the film's audience to the new locale.⁸⁴ Local film production also benefits a city's economy by making it an attractive place for corporations to do business.⁸⁵

In 1996, sixty-seven percent of the nation's total film and video production took place in California, with New York following at seven percent.⁸⁶ "Illinois, Texas, Florida, and Ohio each contributed about two percent to national film industry employment."⁸⁷ All states, and approximately 125 large cities, now have a film commission, which is responsible for marketing and providing other services aimed at encouraging local film production.⁸⁸ Other incentives states are offering include "low-interest loans, financing, property-tax abatements for studio development, free lodging during scouting, full-time film commission liaisons during shooting, rebate/exemption of transient occupancy taxes, free police and fire protection, free or less-restrictive permits, and tax exemptions on property and equipment rentals."⁸⁹

1. *Louisiana*

In 2002, Louisiana introduced the nation's largest entertainment tax-break package, and since then, spending in the state on film and television production has leapt from \$20 million in 2002 to an estimated \$425 million in 2005.⁹⁰ In 2004, the state produced twenty-seven feature films and television movies, up from the five made in 2003.⁹¹ Louisiana offers a tax credit to those who invest in state-certified productions, calculated as a percentage of the total investment in the project.⁹² If total base investment is

83. *Id.*

84. *Id.*

85. *Id.*

86. Weinstein & Clower, *supra* note 15.

87. *Id.*

88. *Id.*

89. *Id.*

90. Elsworth & Brunwasser, *supra* note 58.

91. *Id.*

92. H.B. 731, Reg. Sess. (La. 2005).

between \$300,000 and \$1 million, the production will receive a tax credit of ten percent of the actual investment, and if it is greater than \$1 million, the credit jumps to fifteen percent.⁹³ Further, if total base investment is greater than \$5 million, the tax credit rises to thirty percent of the investment.⁹⁴

Despite the film boom these incentives created, Louisiana still has yet to finish the construction of a sound stage.⁹⁵ One of the main arguments for a bill in California is that "it may cost you a bit more, but everything you need is [t]here."⁹⁶ This argument, however, is losing its force as several sound stages are being built in Louisiana as well.⁹⁷ New Orleans saw membership in its main film union triple, and universities have launched video and film production courses in response to increased student interest.⁹⁸ In addition, the city plans to open a film academy to train specialist workers, and the Louisiana Governor's Office of Film and Television Development sponsors a website posting casting calls and job openings for grips, lighting technicians, and camera operators.⁹⁹ Recent productions include Sarah Jessica Parker's *Failure to Launch*, Martin Lawrence's *Big Momma's House 2*, and Kevin Costner's *The Guardian*.¹⁰⁰

Despite its generous incentives, the fallout from Hurricane Katrina has weakened Louisiana's ability to compete, at least in the short term.¹⁰¹ Some of the problems production companies

93. *Id.*

94. *Id.*

95. Halbfinger, *supra* note 3.

96. *Id.* (quoting Jeff Begun, a vice president of Axiom International, an entertainment production payroll company that tracks incentives by state).

97. *Id.*

98. Christopher Parkes, *Hollywood Horror! Other States Lure Films Away: A Feature Made Out-of-State May Cost California Dollars 10m in Sales and Tax. Would Tax Credits Halt the Exodus?* Christopher Parkes reports, FINANCIAL TIMES (London), Aug. 27, 2005, at 7.

99. *Id.* The website can be accessed at www.lafilm.org. *Id.*

100. Elsworth & Brunwasser, *supra* note 58.

101. Richard Verrier & Claire Hoffman, *Katrina Hits the Gulf Coast: Storm Could Cut Filming in Louisiana*, L.A. TIMES, Aug. 30, 2005, available at <http://www.newsday.com/news/nationworld/nation/wire/cl-fi-holly30aug30,0,2034251.story> (last visited Nov. 8, 2005); Willie Drye, *Hurricane Katrina Smashes Gulf Coast*, NATIONAL GEOGRAPHIC NEWS (2005),

now encounter when filming in post-Katrina New Orleans are inadequate police staff to secure filming locations, insufficient electricity for cameras and equipment, and health threats that remain in the area as a result of the storm.¹⁰² At the Toronto Film Festival in September 2005, however, several of Louisiana's film officials converged to assure filmmakers that the state's film industry is not at risk due to the hurricane, noting that several current projects had already been relocated to Shreveport.¹⁰³ In fact, some producers whose films were disrupted were able to return to the state as early as October 2005 because necessary repairs had already many made.¹⁰⁴ For example, Jerry Bruckheimer will be filming *Déjà Vu* in New Orleans. Significantly, the director of this film, Tony Scott, cited one of the main reasons for choosing the location, aside from the state's incentives, was his plan to make the post-Katrina condition of the city a "third character in the film."¹⁰⁵

To speed the recovery process, in November 2005 the state legislature proposed a new bill which would provide an additional ten-percent credit for employing Louisiana residents, and an additional fifteen-percent credit on base investment spent in the state on a state-certified project, over and above the twenty-five percent credit already offered.¹⁰⁶

at

http://news.nationalgeographic.com/news/2005/08/0829_050829_katrina.html (last visited Feb. 7, 2006). Hurricane Katrina made landfall on August 29, 2005 near New Orleans. It was a Category 4 storm with winds ranging from 131 to 155 miles per hour. *Id.*

102. Ronette King, *Post-Katrina N.O. to Star in Film*, NEW ORLEANS TIMES, Feb. 3, 2006, at <http://www.lafilm.org/media/index.cfm?id=618> (last visited Feb. 7, 2006).

103. Gary Perilloux, *Averting Tragedy: Disaster Befalls New Orleans, but Louisiana's Film Industry is Still Rolling*, BUSINESS REPORT, Oct. 11, 2005, at <http://www.businessreport.com/newsDetail.cfm?aid=6995> (last visited Feb. 7, 2006).

104. Catherine Elsworth, *New Orleans Dusts Itself Off and Starts All Over Again*, TELEGRAPH.CO.UK, at <http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2005/10/21/wkat21.xml&Sheet=/news/2005/10/21/ixworld.html> (last visited Oct. 21, 2005).

105. King, *supra* note 102 (quoting Tony Scott, director of *Déjà Vu*.)

106. H.C.R. 35A, 1st Extraordinary Sess. (La. 2005); see H.B. 731, Reg.

2. *New York*

In 2004, the New York City Council approved a tax credit, the "Made in New York Incentive Program" ("New York Program"), which provides a five percent refundable tax credit to companies filming in the city.¹⁰⁷ Under the New York Program, the work of set designers, costume makers, location scouts, production assistants, camera and sound technicians, caterers, extras, and film editors will be covered by tax breaks, from the up to \$12.5 million in funding available for each calendar year.¹⁰⁸ Combined with state tax credits, film and TV companies would receive a total tax break of fifteen percent.¹⁰⁹

As soon as the program was approved, NBC announced that, because of the tax incentives, its pilot for *NY70* would be shot in New York City instead of Toronto.¹¹⁰ According to Stuart Match Suna, president of New York City's Silvercup Studios, the program makes everyone a winner:

The city is helping to strengthen a \$5 billion industry and in so doing will benefit other businesses as well. The film and television industry

Sess. (La. 2005).

107. Press Release, The Council of the City of New York Office of Communications, Speaker Miller, Council Members, Film and Television Executives Announce New NBC Pilot to be Filmed in NYC (Dec.16, 2004), *available at* http://www.nycouncil.info/pdf_files/newswire/12_16_04_filmtaxcredit.pdf.

108. *Id.*

109. *Id.*; *New York Governor and Mayor: New Incentive Program to Benefit Film Production*, ICOM: FILM & VIDEO PRODUCTION & POSTPRODUCTION MAGAZINE, *at* www.icommag.com/november-2004/november-page-14.html (Nov. 2004). New York state also provides a ten percent tax credit under the "Empire State Film Production Credit Program" enacted in 2004. *Id.*

110. Roger Armbrust, *NYC Filming Should Rise Starting in 2005*, BACKSTAGE MAGAZINE, Jan. 6, 2005, *available at* <http://unitedscreenactors.com/index.cfm?fuseaction=user.item&ThisItem=210> (last visited Feb. 7, 2006). *NY70* is a new cop drama set in New York starring Donnie Wahlberg. Sam Roberts, *New York, No Longer a Crime Capitol, Still Playing One on TV*, NY TIMES, Mar. 14, 2005, *at* <http://www.donniewahlberg.com/031405nytimes.htm> (last visited Feb. 7, 2006).

has a multiplier of two. For every \$1 million spent on a production, an additional \$2 million is spent in the New York economy on ancillary services such as restaurants, retail shops, and other services, making this a win-win for New York.¹¹¹

3. *Illinois*

As mentioned *supra*, the term “runaway production” was coined to describe productions leaving Los Angeles for Chicago during the 1980s when John Hughes began filming many of his films in the Chicago area, such as *Ferris Bueller’s Day Off*.¹¹² The visual media industry has provided 349,062 local jobs and contributed more than \$10 billion to the Illinois Gross State Product since 1976.¹¹³ Illinois is one of the top six productions states in the U.S., having hosted more than nine-hundred feature movies and television productions, including *My Best Friend’s Wedding*, *The Fugitive*, *Road to Perdition*, *Oprah*, *Missing Persons*, and *Early Edition*.¹¹⁴ Chicago is home to twenty acting, video, and film schools, including Columbia College, the largest film school in the

111. Armbrust, *supra* note 110.

112. *Id.*;

([John Hughes was] [o]nce dubbed the ‘philosopher of adolescence’ by film critic and fellow Chicagoan Roger Ebert...[he] made his mark as the man most frequently associated with the 1980s teen angst genre...Originally hailing from Lansing, MI, where he was born..., [John] Hughes was 13 when he moved with his family to the Chicago suburbs. His adopted city would figure largely in his films, providing both a source of inspiration and a familiar setting for his stories.).

Rebecca Flint, MSN MOVIES: ALL MOVIE GUIDE at <http://entertainment.msn.com/celebs/celeb.aspx?c=128233&mp=b> (last visited Nov. 25, 2005). Popular John Hughes films shot in Chicago include *The Breakfast Club*, *Ferris Bueller’s Day Off*, *National Lampoon’s Christmas Vacation*, *Uncle Buck*, *Planes, Trains & Automobiles*, and *Home Alone*. *Id.*

113. Harte, *supra* note 43, at 1.

114. *Id.* at 1, 3.

U.S.¹¹⁵ Chicago City Studios, just one of the twenty-four sound stages in Chicago, is the biggest full-service facility east of Hollywood.¹¹⁶ By 2002, however, Illinois was scrambling to introduce incentives after the embarrassment of having the blockbuster film *Chicago* shot in Toronto.¹¹⁷ Illinois has lost an estimated \$1.9 billion since 1987, as fifty-seven films set in Chicago were filmed in Canada.¹¹⁸

In January of 2004, Illinois passed the Film Production Services Tax Credit Act (hereinafter "Act"), which applied to film, television, and television commercials.¹¹⁹ The Act is designed to preserve and expand the existing motion picture industry in Illinois, and "to promote and encourage the training and hiring of Illinois residents who represent the diversity of the Illinois population through the creation and implementation of training, education and recruitment programs organized in cooperation with Illinois colleges, universities, labor organizations and the motion picture industry."¹²⁰ Under the Act, film and television producers in Illinois receive a twenty-five percent tax credit on the first \$25,000 in wages paid to each employee that is an Illinois resident.¹²¹ To qualify, productions which run for thirty minutes or longer must incur at least \$100,000 in Illinois labor expenditures, and projects shorter than thirty minutes (i.e., commercials) must incur \$50,000 in Illinois labor expenditures to qualify.¹²² The

115. *Id.* at 3.

116. *Id.*

117. Elsworth & Brunwasser, *supra* note 58. The film, *Chicago*, is a derivative originating from a play by *Chicago Tribune* reporter Maurine Watkins. It chronicles the tribulations and dreams of fame of Roxie Hart, a housewife, and Velma Kelly, a vaudeville star, who meet in 1924 at the Cook County Jail on "Murderers' Row." James Berardinelli, *Chicago: A Film Review*, 2002, at <http://movie-reviews.colossus.net/movies/c/chicago.html> (last visited Nov. 29, 2005).

118. Harte, *supra* note 43, at 12.

119. Markus, *supra* note 17; see Illinois Film Production Services Tax Credit Act, DEPARTMENT OF COMMERCE AND ECONOMIC OPPORTUNITY: ILLINOIS FILM OFFICE available at <http://www.illinoisbiz.biz/dceo/Bureaus/Film/taxcredit.htm> (last visited Nov. 23, 2005).

120. ILL. ADMIN. CODE tit. 14, §528.10 (2004).

121. Markus, *supra* note 17.

122. *Id.*

plan's secondary goal is "to keep local talent in Illinois rather than moving to New York or Los Angeles for visual media jobs".¹²³ The credit was only in effect for 2004, at the end of which it was reviewed to determine if it should continue.¹²⁴

On July 11, 2005, Illinois Governor Rod Blagojevich (D) signed Senate Bill 1965, which continued the Film Production Services Tax Credit Act, with one amendment.¹²⁵ The amendment requires applicants to file a diversity plan with the Department of Commerce and Economic Opportunity setting out goals for hiring minorities and females and for using vendors who are certified under the Business Enterprise for Minorities, Females, and Persons with Disabilities Act.¹²⁶ Additionally, salaries for the two highest paid actors are not included in the wages eligible for the tax credit.¹²⁷ The signing ceremony took place on the set of Universal Pictures' *The Break-Up*, a romantic comedy filmed in Chicago, starring Vince Vaughn and Jennifer Aniston.¹²⁸

Still, Illinois incentives remain the least competitive of the top six production states.¹²⁹ To counter this, small business owners and trade people have lowered their rates in an effort to attract more production.¹³⁰ Additionally, unions and guilds are working on negotiating lower fees, modified working conditions, and low-budget agreements.¹³¹

123. *Id.*

124. *Id.*

125. S.B. 1965, 94th Gen. Assem. (Ill. 2005).

126. *Id.*

127. Illinois Film Production Services Tax Credit Act, DEPARTMENT OF COMMERCE AND ECONOMIC OPPORTUNITY: ILLINOIS FILM OFFICE *available at* <http://www.illinoisbiz.biz/dceo/Bureaus/Film/taxcredit.htm>.

128. Gov. Blagojevich Signs Renewal of Landmark Film Legislation That is Bringing Major Productions Back to Illinois and Creating Thousands of Jobs for STA, ILLINOIS GOVERNMENT NEWS NETWORK, JULY 11, 2005, *at* <http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=1&ReNum=4145> (last visited Nov. 29, 2005).

129. Harte, *supra* note 43, at 1.

130. *Id.* at 19.

131. *Id.*

4. Ohio

Ohio is also working on a bill which would create a tax credit based on a film company's total investment.¹³² Productions which incur between \$300,000 and \$8 million in costs would receive a tax break capped at fifteen percent, and more expensive productions would receive a twenty percent credit.¹³³ The sponsor, Senator Patricia Clancy (R) commented, "We feel that if this investment is made in Ohio, more people will want to come, our tourism dollars will increase, and more films will be made here. . .lead[ing] to many more jobs."¹³⁴

5. Other States

Many states, far from being considered traditional film industry states, have successfully passed legislation to entice producers.¹³⁵ Colorado passed a bill in June 2005 requiring the state police departmentss to help production companies obtain state permits, and to give producers sales and user-tax exemptions for making their films in the state.¹³⁶

In April 2005, Maryland passed a bill establishing grant programs which provide a fifty percent rebate for certain specified

132. *States push tax breaks in hope of luring movie business*, *supra* note 34.

133. *Id.*; S.B. 155, 126th Gen. Assem., Reg. Sess. (Ohio 2005). S.B. 155, introduced June 14, 2005, would create a tax credit for investors in state-certified motion pictures, and is currently pending in the Senate Ways and Means Committee. *Id.*

134. *States Push Tax Breaks in Hope of Luring Movie Business*, *supra* note 34.

135. See generally, MARK LITWIK'S ENTERTAINMENT LAW RESOURCES: Domestic Programs at http://www.marklitwak.com/resources/domestic_programs.html.

136. Film Production Companies, COLO. REV. STAT. § 24-48.5-107 (2005). The bill requires the chief of the Colorado state patrol to appoint a member of the state patrol to be the contact person for any production company engaged in film production activities in Colorado, waives all permitting fees for any production company engaged in film production activities in the state, and allows an income tax credit to any taxpayer that makes an investment in a production company that was engaged in film production activities in Colorado. *Id.*

wages paid to state residents working on qualified film productions, though the rebate is capped at a maximum of \$2 million.¹³⁷

In April 2005, New Mexico expanded a tax credit for film companies to reduce a portion of their direct production expenses in New Mexico such as photography and lighting costs.¹³⁸

Finally, Rhode Island, Oregon, and South Carolina have also passed legislation to promote in-state film production.¹³⁹

Other states' legislatures are currently working on the passage of bills to create film production incentives.¹⁴⁰ In July 2005, Texas passed a bill which offered grants to film-makers based on how many workers are hired in Texas, but the state is currently without the \$20 million in funding required to run the program.¹⁴¹ Indiana has a bill pending in the House which would allow film companies free use of state and university property as movie locations and would offer tax credits for the purchase of movie equipment within

137. Film Production Activity: Employer Wage Rebate Grant Program, MD. ANN. CODE art. 83A, §§5-1801-07(2006).

138. Low-Income County Film Production Tax Credit, S.B. 416, 47th Leg., 1st Reg. Sess. (N.M. 2005).

139. H.B. 6201, 2005-2006 Leg. Sess. (R.I. 2005) (applying to any production certified by the Rhode Island Film Office to be in existence on or after January 1, 2005); *see also*, H.B. 2191, 23rd Leg. Assem. (Or. 2005) (creating a labor rebate for costs incurred by persons engaged in film production in Oregon if costs exceed threshold level, creates the Greenlight Oregon Labor Rebate Fund, and continuously appropriates money in the fund to the Economic and Community Development Department for purpose of paying rebates through the Oregon Film and Video Office.); *see also*, H.B. 3152, 116th Gen. Assem. (S.C. 2005) (adding to the Motion Picture Incentive Act an exemption from local, as well as state sales and use taxes, a rebate on all taxable wages, increases the general fund portion of admissions taxes collected, and includes personal services).

140. *See generally States push tax breaks in hope of luring movie business*, *supra* note 34.

141. S.B. 1142, 79th Leg., (Tex. 2005) The bill relates to the creation of a film industry incentive program, and includes television and national or multi-state commercials. It provides a grant program for production companies that pay a specified amount of wages to state residents, and an additional grant for filming in unpopular areas with an offset of any state debt at the time a grant is awarded. *Id.*

the state.¹⁴² Finally, in Tennessee, a bill to establish a film production tax credit for qualified productions is awaiting a committee hearing.¹⁴³

Other states have proposed legislation albeit without success.¹⁴⁴ Nevertheless, it shows that the spread of film production across the United States is growing, and will undoubtedly become even more of a problem for California in the future.¹⁴⁵ In Arkansas, for example, if a production company spends \$500,000 within six months, or \$1 million within one year, it will receive a refund on the purchase of property and services related to the production.¹⁴⁶ Another bill which would have expanded the refund, however, failed.¹⁴⁷ Similar bills have also failed in Alabama and Hawaii.¹⁴⁸

III. PREVIOUS NATIONAL LEGISLATIVE EFFORTS

California first gave tax breaks to the film industry in 1999, with an initiative called "Film California First," which lasted just three years.¹⁴⁹ This initiative reimbursed film companies up to \$300,000 of what they paid to police, fire departments, or other public agencies.¹⁵⁰ Additionally, to counter the expense incurred when post-production houses were converting to costly digital equipment, the state offered an investment tax credit.¹⁵¹

Beyond these efforts, the United States Senate introduced the Independent Film & Television Production Incentives Act of 2001 (IFTPIA), which would have amended the Internal Revenue Code

142. H.B. 1639, 114th Gen. Assem., 1st Reg. Sess. (Ind. 2005).

143. H.B. 1683, 104th Gen Assem. (Tenn. 2005) (concerning taxes, exemption and credits; establishes film production tax credit against taxpayer's excise tax liability, under certain conditions).

144. *See generally States Push Tax Breaks in Hope of Luring Movie Business*, *supra* note 34.

145. *Id.*

146. Harte, *supra* note 43, at 17.

147. *See generally, States Push Tax Breaks in Hope of Luring Movie Business*, *supra* note 34.

148. *Id.*

149. Halbfinger, *supra* note 3.

150. *Id.*

151. *Id.*

of 1986 to allow a United States independent film and television production wage credit.¹⁵² IFTPIA was to address “runaway film and television production,” by granting a wage credit for domestically produced films, television shows or cable programming, mini-series, episodic television and movies-of-the-week provided that wage costs were between \$200,000 and \$10 million.¹⁵³ Under most circumstances, the Act would have credited twenty-five percent of the first \$25,000 in wages paid to any worker.¹⁵⁴ The bill was sponsored by Democratic Senator Blanche Lincoln from Arkansas who called it, “a good way to reinvest in America, looking at our films that have gone offshore because of the incredible incentives that other nations are giving them.”¹⁵⁵ A companion bill, H.R. 3131, was introduced in the House by Republican Representative David Dreier of California in October of the same year.¹⁵⁶ Neither bill made it past the introduction stage, however, due to a dispute over the severity of the runaway problem.¹⁵⁷ Senator Lincoln re-introduced the bill in 2003.¹⁵⁸ This time the bill failed out of concern by some that the legislation amounted to “corporate welfare for the studios.”¹⁵⁹

Under current state and federal law, any expense that is considered “ordinary and necessary” in conducting a trade or business (i.e., wages and benefits), can be deducted from taxes.¹⁶⁰ However, when the business creates a product such as a film, the taxpayer usually has to cover expenses before the product is ready to produce income.¹⁶¹ This means the taxpayer will have to

152. S. 1278, 107th Cong. (2001).

153. *Id.*

154. *Id.*

155. 147 CONG. REC. S. 12030 (2001) (statement of Sen. Lincoln).

156. *Runaway Production: History*, at http://www.dga.org/thedga/leg_rp.php3; see H.R. 3131, 107th Cong. (2002).

157. Halbfinger, *supra* note 3.

158. S. 1613, 108th Cong. (2003).

159. Halbfinger, *supra* note 3.

160. John Pavalasky, *Analysis of Amended Bill: A.B. 777*, CALIFORNIA FILM COMMISSION, May 12, 2005, available at http://www.ftb.ca.gov/law/legis/05_06bills/AB777_081705.pdf (last visited Feb. 12, 2006).

161. *Id.*

capitalize those expenses and amortize¹⁶² them over the period the product actually makes money, using the “income forecast” method of cost recovery.¹⁶³ Amortized expenses include direct costs (researching, preparing, producing, and recording) and indirect costs (utilities, tools, clerical, and equipment rental) as well.¹⁶⁴

The American Jobs Creation Act (AJCA) of 2004, enacted in October 2004, provides an alternative.¹⁶⁵ For qualifying productions between October 22, 2004 and January 1, 2009, the AJCA permits deducting certain production costs in the year during which they are incurred rather than capitalizing the cost and recovering it through depreciation allowances under the income forecast method discussed above.¹⁶⁶ The AJCA also permits a taxpayer to deduct a portion of what he spends on qualified domestic production activities, such as leases, rentals, or licenses of qualified film.¹⁶⁷ California, however, has yet to conform to these provisions.¹⁶⁸

The purpose of the AJCA is to attract investment capital into production, while, at the same time, reduce the cost of the production.¹⁶⁹ The provision only applies to motion pictures,

162. To amortize means to write off an amount of money gradually within a specific number of time periods. David L. Scott, *Wall Street Words: An A to Z Guide to Investment Terms for Today's Investor*, Houghton Mifflin Company, 2003.

163. Pavalasky, *supra* note 160. This method allows “taxpayers to recover the depreciable basis in property over the anticipated income to be earned from the property.” It is often used for interests in motion picture films, video tapes, sound recordings, copyrights, books, and patents because the way these interests make money is based on unique qualities such as popularity, which cannot be measured as accurately using other methods. Guidance on Cost Recovery Under Income Forecast Method, 26 C.F.R. pt. 1 (2002).

164. *Id.*

165. *Id.*; *Runaway Production Update: Special Rules for Certain Film and Television Productions in HR. 4520*, at http://www.dga.org/thedga/leg_rp_updte-101104-a.php3; see also, H.R. 4520, 108th Congress, 2d Sess. (2004).

166. Pavalasky, *supra* note 160.

167. *Id.*

168. *Id.*

169. *Runaway Production: Special Rules for Certain Film and Television*

miniseries, scripted dramatic television episodes (the first forty-four episodes only), and movies of the week, whose budgets do not exceed \$15 million.¹⁷⁰ Additionally, at least seventy-five percent of these costs must have come from services performed in the United States.¹⁷¹ The DGA hopes the added reductions will bolster the increases in production and the associated revenue and jobs resulting from individual state incentive legislation, making the United States more competitive with foreign countries.¹⁷² This legislation, however, is only in effect until 2008, and the Department of Commerce is directed to report by December 31, 2006 on whether it actually helped to retain film productions.¹⁷³

IV. PREVIOUS CALIFORNIA LEGISLATION

The California Film Commission (hereinafter the “commission”) was created under the Motion Picture, Television, and Commercial Industries Act of 1984 (hereinafter, the “Act”) to encourage and promote the film industry in the state.¹⁷⁴ The commission develops and oversees the implementation of the Cooperative Motion Picture Marketing Plan (hereinafter the “Plan”), designed to increase marketing efforts and provide more state resources for marketing locations to producers.¹⁷⁵ Additionally, any resources developed by the commission under the Plan can be used to create additional film commissions.¹⁷⁶ The Act also establishes a Film Promotion and Marketing Fund in the state treasury, from which

Productions in HR. 4520, supra note 165; see also H.R. 4520.

170. *Runaway Production: Special Rules for Certain Film and Television Productions in HR. 4520, supra note 165.*

171. *Id.*

172. *Runaway Production Update: DGA applauds the signing of the American Jobs Creation Act into Law, at* http://www.dga.org/thedga/leg_rp_updte-102204.php3?§ion=thedga&oldsection=&ol (Oct. 2004) (last visited Feb. 4, 2006).

173. *Special Rules for Certain Film and Television Productions in HR. 4520, supra note 165.*

174. CAL. GOV. CODE § 14998 (2005).

175. *Id.*

176. *Id.*

money will be appropriated for use by the commission for activities performed consistent with the Plan.¹⁷⁷

The Act authorizes the commission to receive and deposit money from any supporting public or private institution.¹⁷⁸ Existing as part of the Business, Transportation, and Housing Agency, the commission has twenty-six members, who are appointed by the Governor, the Senate Committee on Rules, and the Speaker of the Assembly.¹⁷⁹ The members consist mostly of various individuals employed in the motion picture industry.¹⁸⁰ The commission's main responsibility is to develop guidelines for and approving or modifying the marketing plan developed by the director.¹⁸¹ In addition, the commission conducts workshops and trade shows, provides expertise in promotional activities, holds hearings, and counsels the Legislature and the Governor on issues pertaining to the motion picture industry.¹⁸² Finally, the commission is responsible for annually reporting the number of productions that begin filming within the state of California.¹⁸³

Other bills have also attempted to address the issue of runaway production.¹⁸⁴ Senate Bill (S.B.) 58, introduced in 2005 and currently in the Senate Appropriations Committee, would provide a refundable credit for certain wages and costs of purchasing or leasing property used during the production of a motion picture in California.¹⁸⁵ Assembly Bill (A.B.) 1830, introduced in 2003, and A.B. 2747, in 2001, would have provided a refundable credit for wages.¹⁸⁶ Both bills failed for reasons which are unclear.¹⁸⁷ A.B. 484, as amended July 14, 1999, would have provided a refundable credit for wages paid during the production of or musical scoring

177. *Id.*

178. CAL. GOV. CODE § 14998 (2005).

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. Pavalasky, *supra* note 160.

185. S.B. 58, 2005-2006 Reg. Sess. (Ca. 2005).

186. A.B. 1830, 2003-2004 Reg. Sess. (Ca. 2003); *see* A.B. 2747, 2001-2002 Reg. Sess. (Ca. 2001).

187. *Id.*

for television programs or movies.¹⁸⁸ A.B. 358, also introduced in 1999, would have provided a refundable credit for wages paid to make television shows or movies, but the Senate Appropriations Committee refused to pass the bill.¹⁸⁹

V. THE PROPOSED SOLUTION: CALIFORNIA'S A.B. 777

The global and national incentives introduced recently led California Assembly Speaker Fabian Nunez (D), on February 18, 2005, to propose A.B. 777: Taxes: Credits: Qualified Motion Picture Production (hereinafter the "Bill").¹⁹⁰ The Bill, supported by the state's Republican governor, Arnold Schwarzenegger, would allocate at least \$50 million a year to the makers of film, television programs and advertisements.¹⁹¹ A.B. 777 authorizes a credit against personal income and corporation taxes for certain wages paid or incurred during the production of each qualified motion picture and for a percentage of production costs paid or incurred while making qualified commercials.¹⁹² If the production company has incurred tax liability, the Bill provides a refund under the Sales and Use Tax Law for qualified motion pictures.¹⁹³ Under this plan, the credits would double the annual amount available from the New York State Film office, but still not match the \$65 million in credits handed out in Louisiana.¹⁹⁴ The Bill gives a twelve percent tax credit on a project's spending in California, capped at \$3 million per production, with an extra three percent

188. A.B. 484, 1999-2000 Reg. Sess. (Ca. 1999).

189. A.B. 358, 1999-2000 Reg. Sess. (Ca. 1999).

190. Elsworth & Brunwasser, *supra* note 58.

191. *Id.*

192. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

193. *Id.*

([A.B. 777] [a]uthorizes a credit against the Personal Income Tax and Corporation Tax laws for specified wages paid or incurred with respect to the production of each qualified motion picture and for a percentage of production costs paid or incurred with respect to production of qualified commercials. [A.B. 777] [p]rovides in lieu of such credits, a credit or refund under the Sales and Use Tax Law for qualified motion pictures.).

194. Halbfinger, *supra* note 3.

credit for television movies, considered the most “endangered species of Hollywood production.”¹⁹⁵

The credits are refundable, meaning that a producer with no tax liability would receive the full amount of the credit in cash from the state, up to fifteen percent.¹⁹⁶ The Bill offers two distinct refundable credits.¹⁹⁷ First, the Qualified Motion Picture Credit is a refundable franchise tax or income tax credit applicable to a percentage of the wages or amounts paid to purchase or lease property used while filming motion pictures.¹⁹⁸ Second, the Commercial Production Credit is a refundable tax credit applicable to the incremental production costs of producing a qualified commercial in California.¹⁹⁹ Both credits can be claimed against sales or use taxes rather than franchise or income taxes.²⁰⁰

Under the proposal, the California Film Commission would have the sole responsibility of allocating the credits.²⁰¹ If enacted, the tax levy would be effective immediately, and would be repealed on January 1, 2016 for evaluation.²⁰² The motion picture credit cannot be based on wages paid, costs for services performed, or for the purchase of property which occurred before January 1, 2006.²⁰³ Likewise, the costs involved in making commercials which were incurred before January 1, 2006 cannot be included in calculating the commercial production credit.²⁰⁴

To avoid allocating too much money to stars’ salaries, the Bill only allows the first \$25,000 of salaries for stars, directors, and other “above the line” talent to be included in the calculation of

195. *Id.* (quoting David Halbfinger, New York Times Arts/Cultural writer).

196. *Id.*

197. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

198. *Id.* Qualified productions include features, movies of the week, miniseries, television series, or commercials where at least seventy-five percent of the principal photography is shot in California. *Id.*

199. *Id.* Qualifying costs would include wages, fringe benefits, payments to independent contractors, payments to personal service corporations, and amounts paid for set design and construction, props, and wardrobe. *Id.*

200. *Id.*

201. Ross, *supra* note 35.

202. *Id.*

203. *Id.*

204. *Id.*

credits.²⁰⁵ Overhead and distribution costs are also excluded to ensure that money is being used for job creation rather than as a subsidy for the studios.²⁰⁶ If a studio does not begin shooting within five months of approval, the tax credits will be forfeited.²⁰⁷ California officials aimed to frame the legislation as narrowly as possible to avoid giving subsidies to productions that are not really at risk for leaving.²⁰⁸ Still, however, the Bill will not be an “exact science.”²⁰⁹ “Qualifying projects will be accepted on a first come first serve [basis],” meaning that some less efficient producers who may need the money more to stay in California could be turned away.²¹⁰ Finally, A.B. 777 would require the California Film Commission, working alongside the Business, Transportation and Housing Agency, the Labor and Workforce Development Agency, and the Franchise Tax Board, to conduct a statewide analysis, covering 1995 to 2005, of the impact of runaway production on the California film industry.²¹¹ This would be submitted with an analysis report to the Legislature by March 1, 2006.²¹²

A. Anticipated Effects of the A.B. 777

According to the California Film Commission, the legislation seeks to change the behavior of production companies by discouraging runaway production in the motion picture industry in the state.²¹³ Louisiana, Pennsylvania, Illinois, New York, New Mexico, Canada, Australia and England have seen a steady

205. Halbfinger, *supra* note 3.

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.* (quoting Amy Lemisch, director of the California Film Commission).

210. *Id.* (quoting Amy Lemisch, director of the California Film Commission).

211. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

212. *Id.*

213. Halbfinger, *supra* note 3 (explaining that under A.B. 777, “runaway production” means the production of movies outside of California, as opposed to federal legislation, which defines it as that occurring outside of the United States); *see also* A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

increase in film, television, and commercial production after passing incentive programs.²¹⁴ The credits are designed to bolster production in California in light of the fact that film commissions from other states and countries are working to entice film, television, and commercial productions away from California.²¹⁵ Additionally, supporters hope that the bill will have the secondary effect of increasing expenditures in other industries, including hotels, catered food, leases of equipment and property, transportation, and wages and salaries paid to individuals in California.²¹⁶

The incentives may not alter the location choice for huge blockbusters like *War of the Worlds* and *The Island*, with budgets enabling them to shoot where they please, but they could affect the decision for films like *Wedding Crashers* or *Herbie: Fully Loaded*, with production costs ranging between \$40-50 million.²¹⁷ A study conducted by the LAEDC used actual production budgets to gauge the resulting jobs, wages, sales tax and income tax from productions.²¹⁸ The study found that a feature film with a \$70 million budget and a seventy-five day shooting schedule in California created jobs for 588 cast and crew members and 1,182 extras.²¹⁹

B. *Current State of A.B. 777*

A.B. 777 passed in the Assembly Committee on Arts, Entertainment, Sports, Tourism and Internet Media on April 19, 2005, and passed in the Assembly Committee on Appropriations on May 25, 2005.²²⁰ The Bill is currently being heard in the Senate

214. SENATE BUSINESS, PROF. & ECON DEVELOP COMM., A.B. 1437, Ca. Legislative Committee Analysis of Pending Bills (July 14, 2005).

215. *Id.*

216. CAL. GOV. CODE § 14498 (2005).

217. Halbfinger, *supra* note 3.

218. *California Film Commission Releases Comprehensive Study on Tax Benefits/Revenue Generated by Film & Television Production; Study Reveals Significant Economic Benefits Entertainment Industry Has on California Economy*, BUSINESS WIRE, Aug. 22, 2005.

219. *Id.*

220. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

Committee on Business, Professions and Economic Development.²²¹ No action has been reported on the Bill since its re-referral to the Senate Committee on Rules on August 22, 2005 and the Senate Committee on Revenue and Taxation on August 25, 2005.²²²

VI. ANALYSIS

A. State Legislative Efforts to Thwart Runaway Production Benefit the U.S. Economy

The American economy has always been based on free enterprise rather than relying on government support.²²³ It has become necessary, however, for the U.S. to find a way to compete with the subsidies offered in foreign countries.²²⁴ The federal government, in comparison to foreign governments, does not offer much by way of production incentives.²²⁵ Additionally, because of the federal deficit, there is little chance of seeing any substantial recourse in the near future.²²⁶ Therefore, state legislation is currently the best mechanism for competing against foreign incentives.²²⁷ Luckily, states have recognized this, and are taking action in their own legislatures.²²⁸

While providing competition against foreign countries, state legislation, over and above benefiting local economies, benefits the United States economy.²²⁹ As discussed above, dollars spent on local production promote a variety of other industries as well as

221. *Id.*

222. *Id.*

223. Mark Litwak, Esq., *Soft Money in Hard Times: The International Hunt for Production Incentives is On*, MOVIEMAKER: THE ART AND BUSINESS OF MAKING MOVIES, at <http://www.moviemaker.com/issues/53/softmoney.html> (last visited Feb. 6, 2006).

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. Harte, *supra* note 43, at 17.

229. Litwak, *supra* note 223.

attracting tourism.²³⁰

When the Director's Guild of America (DGA) interviewed Senator Blanche Lincoln, the sponsor of the IFTPIA, she stressed the influence of the incentives in states not traditionally thought to be involved in film production.²³¹ According to Lincoln, the public perception that runaway production is just a California issue is false.²³²

[Residents of] rural states really benefit more than anybody when a production comes in because it's the locals who gain. It's the restaurants, the hotels and motels, the electricians, the contractors, the investment in the infrastructure that a film company would make. It's a tremendous boost to a small community in a rural area when productions come in, but they're not coming to rural America anymore. . . This is an industry that we need to bring back into our communities because it bolsters the local economy. There needs to be an incentive to keep those productions in this country.²³³

B. The Problems with A.B. 777

A.B. 777, while strongly supported by labor unions, Hollywood studios, and influential Los Angeles-area lawmakers, faces opposition.²³⁴ First, there is ample evidence to support the argument that the film and entertainment industry is not even in crisis. Studies conducted by the California Budget Project indicate that employment in the entertainment industry in California has

230. *Id.*

231. *DGA Interview with Senator Blanche Lambert Lincoln*, DGA MAGAZINE: RUNAWAY PRODUCTION, Sept. 2001, at http://www.dga.org/news/v26_3/feat_runawaylincoln.php3 (last visited Feb. 5, 2006).

232. *Id.*

233. *Id.*

234. Marc Lifsher & Evan Halper, *Bill Would Refund Film Companies*, L.A. TIMES, Aug. 24, 2005 at 1.

steadily increased against that in other industries in the state.²³⁵ Second, the qualification requirements for receiving benefits are controversial. The threshold dollar requirement for a film's budget may result in wasting state revenue on films that have no inclination of even leaving California. Additionally, the Bill does not require that the workers which a production receives credit for hiring be California residents. Third, the fact that the credits would be refundable if the production faces no tax liability is controversial. Many worry that refundable credits mean that the credits will ultimately benefit those who are already wealthy. Fourth, with California already facing a budget deficit, funding the entertainment industry to the detriment of other state programs, such as education and public services, is a bad idea. Finally, A.B. 777 does not counter all the causes of the problem of runaway production.

1. Providing Refundable Credits Risks Allocating State Funds to Those Who Need It Least

A.B. 777 offers a cash refund to production companies that have no tax liability against which to apply the credits.²³⁶ It is common in the film industry for production companies to have no tax liability because it is standard practice to form a new partnership, corporation, or other ownership entity for each production.²³⁷ California does not currently offer refundable credits for businesses, which means A.B. 777 could set a precedent for other industries to claim they are owed the same.²³⁸

As mentioned above, the Bill offers two distinct refundable credits, the Qualified Motion Picture Credit and the Commercial Production Credit.²³⁹ The fact that these credits are refundable is controversial across the board. Lawmakers in both the Republican and Democratic parties resist refundable credits.²⁴⁰ Supporters of

235. Ross, *supra* note 35.

236. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

237. Ross, *supra* note 35.

238. *Id.*

239. A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

240. Halbfinger, *California Bill on Tax Breaks for Filming Faces Delay*, THE

the Bill claim that it helps keep middle-class jobs in California.²⁴¹ However, Dan Walters, a columnist for the *Sacramento Bee*, called the Bill “a blatant giveaway of public funds to affluent participants in one relatively insignificant sector of the economy,” and questioned why “taxpayers [should] be giving tens of millions of dollars to an industry best known for its lavish lifestyles.”²⁴² The Bill would provide producers who owe no income taxes as much as \$3 million in refundable credits.²⁴³ Over the span of ten years, this could accumulate to a loss of as much as \$1 billion.²⁴⁴

2. *The Qualification Requirements are Controversial*

Two issues concerning qualification requirements under A.B. 777 are cause for concern. The first of these issues is the budget cut-off for qualifying films. There is a strong argument that it is falsely calculated, allowing state funds to go to films not at risk of leaving California for production. Second, the Bill gives credits to production companies for hiring employees, regardless of whether or not these employees are from California.

a. *The Budget Cut-off for Qualification Results in Wasted State Funds*

Republican concerns center on how there are few restrictions for producers of film to qualify for credits, while producers for television series and commercials face much more demanding criteria.²⁴⁵ The argument is that the \$500,000 threshold for

NEW YORK TIMES, Sept. 8, 2005.

241. Halbfinger, *supra* note 3. (quoting California Assembly speaker Fabian Nunez (D-LA) as saying, “When you start losing middle-class jobs to other states, you’ve got to at some point figure out how to make an investment to keep those jobs in California. The Hollywood industry is a blue-chip industry that is based in California. We want to keep it here.”).

242. Lauren Horwitch, *SAG-Backed Tax Credit Bill Struggles in California*, VNU BUSINESS MEDIA BACK STAGE, Sept. 8, 2005, at 3.

243. Marc Lifsher, *Runaway Film Bill Hits Snag*, L.A. TIMES, Sept. 8, 2005 (on file with the author).

244. *Id.*

245. Jesse Heistand, *Untitled*, THE HOLLYWOOD REPORTER, Sept. 9, 2005

qualification is too low, and will lead to subsidizing a whole class of motion pictures that have only a low likelihood of leaving the state.²⁴⁶ Some supporters of the bill claim that the credits will “pay for themselves” in added economic activity, but there has been no reliable evidence to support this position.²⁴⁷

According to *The Migration of Feature Film Production from the U.S. to Canada and Beyond* (hereinafter “Migration”), a study conducted in 2001 by the Center for Entertainment Industry Data and Research, it is the feature films with gross budgets in the \$10.1 to \$50 million range that are the most affected by the incentives offered in Canada.²⁴⁸ Since Canada introduced its rebates, films shot there with gross budgets within that range increased by 141 percent from 1999 to 2001.²⁴⁹ In the U.S., productions in this range showed a thirty-eight percent increase from 2000 to 2001.²⁵⁰ The category of films with gross budgets greater than \$50 million showed the greatest change between 2000 and 2001.²⁵¹ Overall, North American spending in this category decreased by twenty-six percent, from a high of \$2.4 billion in 2000 to \$1.8 billion in 2001.²⁵²

In contrast, of feature films shot in North America with budgets of \$10 million or less, eighty-five percent were filmed in the U.S. and only fifteen percent in Canada.²⁵³ According to the Migration study, reasons that smaller-budget films did not run away are many, and include the strong guilds and unions present in California, and the fact that the U.S. already has plenty of

(on file with author) (noting that Democrats oppose the bill as well, though their main concern is the amount of money the government would spend under the Bill).

246. See generally, Halbfinger *supra* note 3.

247. Ross, *supra* note 35.

248. Stephen Katz, *The Migration of Feature Film Production from The U.S. to Canada and Beyond -Year 2001 Production Report*, CENTER FOR ENTERTAINMENT INDUSTRY DATA AND RESEARCH, 2001 available at <http://www.ftac.org/files/ceidr2001.pdf> (last visited Feb. 12, 2005).

249. *Id.*

250. *Id.*

251. *Id.*

252. *Id.*

253. *Id.*

available talent, crews, and unique locations. On the other hand, the savings a film will experience in Canada decrease proportionately to the size of the film, and it is more difficult to find a decent crew there on a low budget.

As illustrated above, it is understood that films with a budget under \$10 million are highly unlikely to leave California.²⁵⁴ Critics want to see the Bill reworked to provide more safeguards against giving money to productions that are never really going to leave.²⁵⁵ An *L.A. Times* article illustrated:

Keeping [a] production in Burbank instead of Baton Rouge means the state would have to spend only \$3 million (in tax credits) to make \$7 million (in tax revenue). But [] if the feature would have been made largely in California anyway. . . Then the gain evaporates, and the state simply chalks up a \$3 million loss[,] [a]nd its hard to imagine how a credit could be designed to reward only those features that were in danger of becoming runaway productions.²⁵⁶

b. No Residency Requirement Means Producers Are Credited With State Funds Without Giving Anything Back

A.B. 777 does not require producers or companies to hire solely within the state of California in order to receive credits.²⁵⁷ As a result, the producer can end up receiving tax credit for hiring someone who does not even pay taxes to the state of California. Louisiana and Illinois, comprising a large segment of the competition California faces, *both* require local residency as a

254. *States Push Tax Breaks in Hope of Luring Movie Business*, *supra* note 34.

255. Halbfinger, *supra* note 3.

256. *Hollywood Shuffle*, *L.A. TIMES*, Aug. 25, 2005 at B12 (on file with author).

257. Katz, *supra* note 248; *see also* A.B. 777, 2005-2006 Reg. Sess. (Ca. 2005).

precondition for receiving government funds, as do Australia and Canada.²⁵⁸ When a production runs away, almost all of the work is done by crew directors, crew members, and grips hired in the foreign location.²⁵⁹ This results in immediate job loss in the U.S.²⁶⁰ Additionally, state and federal governments end up losing income tax revenues.²⁶¹ Adding a residency requirement ensures that money spent by the state stays in the state economy.²⁶²

Another reason the lack of a residency requirement presents a serious problem is because of the prevalent use of loan-out corporations in the motion picture industry.²⁶³ A loan-out corporation is a practice in which the artist company will “loan-out” the artist’s services to the party contracting with the corporation.²⁶⁴ The contract is between the loan-out corporation and the production company, not with the artist.²⁶⁵ Because the artist’s salary offsets the corporation’s income, a loan-out corporation is generally able to avoid recognizing any income in the state the artist finds work.²⁶⁶ Thus, the use of the artist by the state does nothing to bring in income tax revenue, but rather, the state in which the loan-out corporation is situated continues to receive any tax revenue the company generates.²⁶⁷ While the IRS has attacked this situation in the past, the use of loan-out

258. See *supra* Part II(B)(1) & (3); see *supra* Part II(A)(1) & (2).

259. *U.S. Runaway Film and Television Production Study Report*, MONITOR COMPANY at II(D), at http://www.dga.org/news/pr_runaway.pdf (last visited Feb. 12, 2006).

260. *Id.*

261. *Id.*

262. *Id.*

263. *Film Financing and Television Programming: A Taxation Guide* (3d Ed.), KPMG, at <http://americanjobscreationact.com/cpa-opinions/KPMG.htm> (last visited Feb. 12, 2006).

264. Scott Hervey and Patrick Olguin, *Music Industry Glossary: Corporation (Loan-Out)*, SACRAMENTO NEWS & REVIEWS, at <http://www.newsreview.com/sacramento/Content?oid=oid%3A13571> (last visited Feb. 12, 2006).

265. *Film Financing and Television Programming: A Taxation Guide*, *supra* note 263.

266. *Id.*

267. *Id.*

corporations by artists is not currently being challenged.²⁶⁸ Therefore, it is likely the additional income from productions that stay in California due to the incentives will not offset the subsidy of providing them.

3. *The Film Industry in California is Not in Crisis*

Proponents of a tax credit solution to the runaway production problem often claim a decrease in industry employment to support their argument.²⁶⁹ The numbers clearly counter this position. Employment in the entertainment industry in California increased 30.5 percent between 1994 and 2004 and an additional fourteen percent in 2005 alone.²⁷⁰ This is significant, considering total employment in California rose only 1.5 percent during the same period.²⁷¹

Overall, actual production days for the entertainment industry in Los Angeles have increased in recent years.²⁷² Total production days increased 18.9 percent to 52,570 between 2003 and 2004.²⁷³ Features production days rose 24.9 percent during the first quarter of 2005, as compared to the first quarter of 2004.²⁷⁴ Production days for commercials qualifying under the commercial production credit increased by over one thousand between 2003 and 2004.²⁷⁵ While it is true that the share of U.S.-developed productions that were filmed outside California for economic reasons increased from forty-four in 1990 to one hundred in 1998, during that same period, the number of U.S.-developed productions that remained local also increased, from 223 to 363.²⁷⁶

Many proponents of A.B. 777 cite a 1999 study conducted by Monitor Company (hereinafter “Monitor”), a management consulting firm, which indicates that California’s economy has

268. *Id.*

269. Ross, *supra* note 35.

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.*

274. Ross, *supra* note 35.

275. *Id.*

276. *Id.*

experienced a \$10.3 billion loss from runaway production, with the entertainment industry directly employing 164,000 and indirectly employing another 184,000.²⁷⁷ However, Monitor excluded numerous segments of the film industry including animated films, commercials, daytime soap operas, documentaries, foreign films, foreign language television, game shows, infomercials, music videos, news programs, and television specials.²⁷⁸ These exclusions mean that Monitor likely overstated the impact runaway production has on California.²⁷⁹ A *Los Angeles Times* article even noted that television plays a huge role as the driving job creator in Hollywood.²⁸⁰ Additionally, a study conducted by four Canadian industry organizations covered the same period as the Monitor study, and estimated only a \$1.7 billion loss.²⁸¹ These groups accused the Monitor Study of gross exaggeration and accounting and arithmetic errors.²⁸²

Additionally, LAEDC released a study in August 2005 to illustrate how production benefits the economy of California and how much the state incurs when production runs away.²⁸³ LAEDC reports that when a \$70 million budget movie is filmed outside California, the state experiences a loss equivalent to 141 full-time one-year jobs.²⁸⁴ LAEDC also asserts that economic output

277. *Id.*; see also, James Jaeger, *The Movie Industry*, MATRIX ENTERTAINMENT at <http://www.mecfilms.com/moviepubs/memos/moviein.htm> (last visited Nov. 28, 2005).

278. Ross, *supra* note 35.

279. *Id.*

280. Richard Verrier, "Movies Schmovies – TV's Taking Over L.A.," L.A. TIMES, at <http://www.latimes.com/business/custom/cotown/cl-fi-tvjobs19aug19,1,929310.story?coll=la-headlines-business-enter>. (last visited Feb. 8, 2006) (Noting that "while Hollywood's nomadic film business has gravitated toward cheaper U.S. and foreign locales, television production has become the bedrock of the Los Angeles entertainment economy").

281. *Id.*

282. *Id.*

283. *California Film Commission Releases Comprehensive Study on Tax Benefits/Revenues Generated by Film & Television Production; Study Reveals Significant Economic Benefits Entertainment Industry Has on California Economy*, BUSINESS WIRE, Aug. 22, 2005 at http://www.californiafilmindustry.com/News/California_film_commission.html.

284. *Id.*; see *supra* Part II.

generated by a production of this size is \$199 million, resulting in at least \$10.6 million in state tax revenue.²⁸⁵ Where this study fails, however, is that it does not assess the impact the credits would have on employment or state tax revenues.²⁸⁶ The LAEDC study only looks at one side of the story.²⁸⁷ Particularly, the study does not address the significant point that the credits will divert tax dollars from other industries in the state.²⁸⁸ In reality, employment in the motion picture industry increased by fourteen percent, surpassing the total employment growth among all California industries, which only increased by 1.5 percent.²⁸⁹

California is currently facing a budget deficit.²⁹⁰ It is inevitable that A.B. 777 will eat into funding for other state programs, such as education and public health care, both critical and unsettled issues.²⁹¹ While the credits the legislation offers would be as rich as some offered in other states,²⁹² the question becomes whether choosing entertainment over education and health care is the best use of public resources.²⁹³ Currently, baseline spending in California exceeds revenue, meaning that any dollars spent on the film industry will directly reduce expenditures or increase taxes on other individuals or businesses.²⁹⁴ This essentially means that any benefit received as a result of the Bill will only come at the price of lost jobs and higher taxes in other sectors of the state's economy.²⁹⁵ For example, suppose school funding is cut by \$100

285. *California Film Commission Releases Comprehensive Study on Tax Benefits/Revenues Generated by Film & Television Production*, *supra* note 283 (defining economic output within the LAEDC study as "the increase in gross receipts resulting directly and indirectly by economic activity associated with production spending.").

286. Ross, *supra* note 35.

287. *Id.*

288. *Id.*

289. *Id.*

290. *Id.*

291. *Our Views: Hollywood Handouts?*, THE PRESS ENTERPRISE, Aug. 23, 2005, at 8b (on file with the author).

292. Halbfinger, *supra* note 3.

293. Ross, *supra* note 35.

294. *Id.*

295. *Id.*

million a year to provide funds for credits under A.B. 777.²⁹⁶ The result will be that local “school districts will receive fewer dollars and employ fewer teachers, school bus drivers, and other staff, or at least reduce their wages.”²⁹⁷ While Republican legislators acknowledge the beneficial effect the credits would have on the film industry, they do not want to give preference to this industry when other, more essential segments of the economy could equally benefit from government aid.²⁹⁸ Senate Minority Leader Dick Ackerman (R-Irvine) told Governor Schwarzenegger he wanted to explore a variety of incentives, such as tax credits for the purchase of manufacturing equipment, as part of the 2006 budget.²⁹⁹ He said that because Republicans generally do not favor corporate subsidies, they want to first look at some of the other industries which are threatening to move out.³⁰⁰ Jean Ross, Executive Director of the California Budget Project, called the incentives “far too rich. . . [and] the first fully refundable corporate tax credit passed by the Legislature, [which sets] ‘a costly precedent.’”³⁰¹

4. *Exclusions of Controversial Topics Could Prove Unconstitutional*

There is also some worry that the bill’s method for disqualifying pornographic films from the tax break could be unconstitutional.³⁰² A.B. 777 would exclude productions that are subject to federal registration under provisions governing sexual exploitation and other abuses of children.³⁰³ However, this exclusion covers only “actual but not simulated conduct.”³⁰⁴ The exclusion would not cover graphic violence and many other categories of conduct which many may deem offensive.³⁰⁵ In short, while news reports

296. *Id.*

297. *Id.*

298. Lifsher, *supra* note 243.

299. *Id.*

300. *Id.*

301. Halbfinger, *supra* note 3.

302. *Our Views: Hollywood Handouts?*, *supra* note 291.

303. Ross, *supra* note 35.

304. *Id.*

305. *Id.*

and documentaries would not be eligible under A.B. 777, many films with graphic and sexual material, so long as it is not “actual,” would be able to receive taxpayer-supported assistance.³⁰⁶ The argument is best presented by Jean Ross, who prepared a brief on runaway production for the California Budget Project:

Some suggest that even the minimum exclusion contained in this measure might be deemed to infringe on the freedom of speech protections offered by the First Amendment to the U.S. Constitution. Such content provisions also may provoke controversy over what role the state should play in subsidizing productions with other potentially controversial content, such as extreme violence or politically sensitive issues.³⁰⁷

Under A.B. 777, California taxpayers subsidize film production. As such, they are the group most likely to be upset with the Bill. Therefore, legislators should temper any negative taxpayer reaction to the Bill by refusing to subsidize productions that the public would find offensive or immoral.

5. The Solution Does Not Address All of the Causes of Runaway Production

A report produced by the Commerce Department’s International Trade Administration (ITA) states that tax incentives are far from being the sole cause of runaway production.³⁰⁸ The ITA reports

306. *Id.*

307. *Id.* The California Budget Project (CBP), founded in 1994, provides Californians information about state fiscal policy issues. The purpose of CBP is “to improve public policies affecting the economic and social well-being of low and middle-income Californians.” *Id.*

308. Morrie Goodman and Jim Plante, *Commerce Secretary Mineta Releases Report on the Impact of the Migration of U.S. Film and Television Production*, U.S. DEP’T OF COMM., Jan. 18, 2001, available at <http://www.ita.doc.gov/media/commerceNews/filmmigration12001.htm> (last visited Feb. 12, 2006).

that a large amount of runaway production is a result of globalization. Additionally, foreign exchange rates and technological changes are contributing to the need for the motion picture industry to expand beyond national borders.³⁰⁹

Aside from the commercial aerospace industry, the U.S. entertainment industry gets more of its revenue from overseas sales than any other industry.³¹⁰ Globalization makes it easy for foreign companies to distribute American entertainment goods including music, books, and movies, and the audience for these goods has been growing steadily.³¹¹ A.B. 777 can be seen as an effort to thwart the globalization of the film industry. Realistically speaking, globalization is a cause of runaway production that cannot be eliminated. Moreover, it may be that it would prove harmful to attempt to do so. While globalization may lead some films to be produced abroad, it also has the counter-effect of providing an additional market for U.S. goods.

Canada provides one of the best illustrations of a country where U.S. cultural products dominate.³¹² Canada's film ticket sales are only from Canadian films 2.1 percent of the time, the remaining ninety-eight percent being primarily American.³¹³ Moreover, seventy-five percent of the television programs watched, eighty percent of magazines sold on newsstands, and seventy percent of radio content come from foreign sources, and more times than not, it is American.³¹⁴ If the United States takes a negative stance toward the production of its films abroad, foreign countries could begin to negatively react to its cultural products, creating decreased income from foreign sales.

Attractive foreign exchange rates (especially in Canada and

309. *Id.*

310. Center for Strategic and International Studies (CSIS), *Cultural Impact #2: Pop Culture*, at <http://www.globalization101.org/issue/culture/28.asp> (last visited Nov. 30, 2005). Globalization101.org is a website dedicated to providing students and others with information about globalization. It is managed by the Center for Strategic and International Studies (CSIS), and all material on the site was written by CSIS staff and is protected under common-law copyright.

311. *Id.*

312. *Id.*

313. *Id.*

314. Center for Strategic and International Studies, *supra* note 310.

Mexico) are a second reason runaway production has become a problem in the United States.³¹⁵ When the dollar is strong, the labor rates will be lower in countries with a weaker currency.³¹⁶ An example provided by Kevin Wright, marketing specialist for the Colorado Film Commission, demonstrates how this works:

For example, a grip hired in Los Angeles from the International Alliance of Theatrical Stage Employees (IATSE), Local 80, costs a production company approximately \$24.72 per hour. A grip in Vancouver from IATSE, Local 891, costs a production company approximately \$21.68 per hour. However, the exchange rate and rebates from the government can reduce that amount to \$15.00 per hour.³¹⁷

In other words, production companies can go further with the American dollar in other countries. This situation is changing, however. The exchange value of the dollar is currently low, and keeps falling, which provides California with a competitive edge over foreign locations for productions.³¹⁸ A.B. 777 can do nothing to counteract the current state of exchange rates. It is a phenomenon that cannot be controlled by one piece of legislation. This is not to say that legislation, if well-crafted and economically sound, is never going to be beneficial, but it does mean that certain circumstances may make the effort futile.

Finally, the technological revolution in the industry has contributed to the phenomenon of runaway production.³¹⁹ Technical people involved in the production of a film no longer

315. Kevin Wright, *The New Film and Video Industry: Getting Our Share*, ADVERTISING AND MARKETING REVIEW, at http://www.ad-mkt-review.com/public_html/docs/fs030.html (last visited Feb 12, 2006).

316. *Id.*

317. *Id.*

318. *What is the Cost of Runaway Production?*, LOS ANGELES COUNTY ECON. DEV. CORP., (2005), available at http://www.film.ca.gov/ttca/pdfs/link_overview/cfc/California_Film_Commission_Study.pdf. (last visited Feb. 12, 2006).

319. Center for Strategic and International Studies, *supra* note 310.

need to be near the actual production site.³²⁰ Before, the directors, actors, producers, and other specialists and technicians had to be on hand to review and approve the highly technical work of the various editors.³²¹ Now, as soon as a film is shot, it is digitalized so it can be transmitted over the internet to editors sitting at a computer anywhere in the world.³²² Distance and national boundaries are no longer cause for concern.³²³ Sophisticated software is now used to edit the scenes, and editors can get instant feedback from directors, actors, and others in the event the film needs to be re-edited.³²⁴ The new software and hardware available eliminate some of the need to develop sound stages.³²⁵ Additionally, the invention of high-definition cameras has made it easier for foreign companies to compete.³²⁶ Most of U.S. post-production facilities are currently not equipped to function in high definition.³²⁷ Before these technological changes, it would have been inefficient to produce a film in many foreign countries, even if the country had low labor costs.³²⁸ Today, however, many countries can provide full production without any outsourcing, including sound stages and skilled labor.³²⁹ In sum, allowing films to “run” with the shift of globalization and film abroad may lead to more efficient production and higher quality films. If high-definition film can only be achieved by combining efforts with other countries, then it makes sense to support it.

320. *Id.*

321. *Id.*

322. *Id.*

323. Wright, *supra* note 315.

324. Center for Strategic and International Studies, *supra* note 310.

325. Wright, *supra* note 315.

326. *Id.* Use of high-definition cameras allows for instant review shots, without having to wait for the film to be processed and transferred to tape. The shots are instead digitized, eliminating the need to use specialists and saving the production studios millions of dollars. *Id.*

327. *Id.* The Federal Communications Commission (FCC), however, plans to transition to digital and high definition television, though the replacement or upgrade of equipment will be very costly. *Id.*

328. Center for Strategic and International Studies, *supra* note 310.

329. *Id.*

VII. ALTERNATIVE SOLUTIONS

There are alternatives to creating a tax subsidy. The California legislature should await resolution of the many concerns surrounding A.B. 777 before enacting it. This is an especially reasonable course of action, considering the fact that Hurricane Katrina has weakened California's largest national competitor, Louisiana.³³⁰ While Louisiana film officials do indicate that the state continues to attract producers despite the devastation, it is inevitable that it will take some time for the Louisiana economy to completely recover its position.³³¹ Many of the structures, such as the sound stages that were under construction, need to be rebuilt.³³² Also, the academic programs facilitating the introduction of local experts into the Louisiana entertainment industry will have to be re-established.³³³ The need to pass A.B. 777 is currently less pressing than before, and California should use this time to carefully assess alternative solutions.

One solution which has been proposed repeatedly over the past decade is the use of trade regulation rather than tax subsidies. Former Assistant Secretary of Commerce Alan Dunn supports this alternative.³³⁴ According to Dunn, "there are lots of holes in the subsidy argument. . . [Subsidies] are slow, expensive, create an unpredictable playing field, and spiral competition downward."³³⁵

Dunn believes Section 301 of the World Trade Organization (WTO) is the best weapon to fight runaway production.³³⁶ Section 301 is a tool for the U.S. to assert international trade rights,

330. See *supra* text accompanying note 101.

331. See generally Part II (B)(1).

332. *Id.*

333. *Id.*

334. Cherri Senders, *Five Experts Present Diverging Solutions, Viewpoints on Runaway Production*, INTERNATIONAL CINEMATOGRAPHERS GUILD, Jul. 20, 2005, at http://www.cameraguild.com/news/genindustry/05-07-20_viewpoints_on_runaway_production.html (last visited Feb. 6, 2006). ("Alan Dunn has served as a lead U.S. negotiator regarding issues of subsidies and antidumping in negotiations with Canada and Mexico on NAFTA and GATT, which established the World Trade Organization.").

335. *Id.*

336. *Id.*

including rights under WTO agreements.³³⁷ Under the “Special 301” provisions of the Trade Act of 1974, any trading partners that deny sufficient protection of intellectual property or deny market access to U.S. industries that rely upon intellectual property protection are identified by the United States Trade Representative (USTR).³³⁸

Section 301 would permit the film industry, if it is adversely affected by subsidies or other trade measures in another country, to file a Section 301 petition with the USTR to negotiate for the removal of those measures.³³⁹ If the offending country fails to meet its obligations under the WTO, the petition would go to a dispute settlement body.³⁴⁰ With a number of foreign countries currently offering subsidies, the first question to ask would be which countries to challenge, and in what order.³⁴¹ As discussed above, the main international threats California faces are Canada, Australia, the U.K., China, and several Czech Republic nations.³⁴² With these key threats already identified, California has a starting point for pursuing this remedial avenue.³⁴³

337. 19 U.S.C. § 2411 (2005). Section 301 of the Trade Act of 1974, as amended, is cited as 19 U.S.C. § 2411. This is the provision that gives the United States the authority to impose trade sanctions against countries that violate trade agreements, act discriminatorily, or unduly burden U.S. commerce. *See also*, *USTR Releases 2005 Special 301 Report*, TECH LAW JOURNAL (Apr. 29, 2005), at <http://www.techlawjournal.com/topstories/2005/20050429.asp> (last visited Feb. 12, 2006).

338. 19 U.S.C. § 2411 (2005).

339. Senders, *supra* note 331.

340. 19 U.S.C. § 2411 (2005).

341. *Id.*

342. *See supra*, Part II(A).

343. While the costs of filing a 301 Petition start at \$175,000, this alternative could prove costly. The Motion Picture Association of America (MPAA), however, currently uses this same trade law, Section 301, to fight piracy. 19 U.S.C. § 2411 (2005); *see also* International Intellectual Property Alliance, *Milestones of the International Intellectual Property Alliance: Twenty Years of Global Copyright Reform (1984-2004)* (2004), available at http://www.iipa.com/pdf/IIPA_Milestones_20_years_100704b.pdf (“In February 2004, IIPA filed its sixteenth [] Special 301 submission with [the] USTR. This submission again comprehensively detailed piracy rates and estimated losses due to piracy, analyzed legal and enforcement deficiencies, and recommended corrective actions in dozens of countries.”).

Tim McHugh, a co-director of The Film and Television Action Committee (FTAC), also supports this alternative, stating that, the FTAC has decided to pursue trade remedies as a more permanent solution.³⁴⁴ The argument is that “subsidies [] don’t create jobs, they just move them around - either state to state, or country to country. . . .”³⁴⁵

Another route would be for California to simply offer a more focused grant or rebate program, which would apply only to those productions known to be at risk of leaving California in the absence of an incentive to stay.³⁴⁶ Grant programs, especially, are easy to tailor because of the lengthy application processes.³⁴⁷ A special committee could analyze each case to ascertain whether or not it is a potential “runaway” by considering several factors, such as the amount of financing the production currently has, the nature and setting of the film, and whether or not key players (directors and main actors) are local or foreign. This would prevent all productions from being able to threaten “running away” just to receive government aid.

Regarding the national competition problem, there is little reason to see runaway production as anything but healthy competition between states. One of the main reasons filmmakers ventured to California in the first place was for the gorgeous backdrops the state provided. If a film is set in a suburban neighborhood in the middle of January, there is no reason why states able to offer such a wintry backdrop should not be able to compete with each other for it. America has always been a market-driven economy. The best solution to this national problem is to do nothing. Each state will remain responsible to its own constituents for ensuring that other industries, such as education and health care, maintain funding. This will provide a natural and healthy limit on how much each state can spend to compete for revenue-boosting entertainment productions.

The real problem caused by runaway production involves

344. Senders, *supra* note 334.

345. *Id.* (quoting Former Assistant Secretary of Commerce, Attorney Alan Dunn).

346. Ross, *supra* note 35.

347. *Id.*

employment. A.B. 777 risks exacerbating the problem in California. Under the Bill, California taxpayers would pay five percent extra in taxes to subsidize the program. Because the Bill lacks a residency requirement for employees hired during the production, this money is likely to fall into the hands of an already wealthy producer who may have hired as much of his cast and crew from out of state in order to avoid tax liability, so that he can collect his credit.

VIII. CONCLUSION

The film industry does contribute greatly to the economy of California. The loss this industry has suffered as a result of runaway production should not be ignored. State legislative efforts have done much to help cushion the negative effects of runaway production in the entertainment industry as well on the overall economy of the United States. However, the current proposal, A.B. 777, does not sufficiently address the problem in a fair and economical manner.

The best option for California at this point is to consider ways in which it could solve the problems of A.B. 777 that have left many critics concerned. The California legislature should use this time to conduct a more thorough and inclusive study into exactly how much its film industry has been impacted by runaway production. In addition, support for the Bill would greatly increase if the legislature would reconsider making residency a requirement for receiving the refundable credits, or at least consider modifying the Bill by enacting certain requirements for receiving the refundable credits. This would ensure state revenue is not wasted on the already wealthy film industry, since there are many other public programs that could use the extra money. Additionally, the production budget cut-off necessary to qualify for credits needs to be narrowed.

California's need for legislation is not as immediate as it was before Hurricane Katrina. Moreover, the numbers indicate that the industry in California has not ever needed any legislation.³⁴⁸ The state should use this time to more carefully assess the potential effects of A.B. 777, and work to find a more equitable solution.

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348. *See supra* Part VI.(B)(3).

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